RICHARD RUSSELL'S DOW THEORY LETTERS, INC.
P.O. Box 1759, La Jolla, California 92038
36 Letters per year — $150 Annually
Registered with the Securities and Exchange Commission

November 5, 1976 LETTER 680

Oct. 22, DJIA 938.75; PTI 688; A-D Ratio -23.99
Oct. 29, DJIA 964.93; PTI 707; A-D Ratio -23.17

PATIENCE: IBM may be America's greatest growth company and they do indeed have $5.8 billion in cash reserves, but they can't get our composer type here on time. So, I still am using the "too small" type on the latter part of this report, and I'll have to ask readers to bear with me again. The next report should have all the right sized type!

THE PICTURE: I'm writing the first page or so of this Letter on Tuesday, November 2, and obviously I don't know at this moment who's going to win the election. By the time I finish this report I will know (so will the market), and I will comment on the situation in the "Late Notes" section.

Of course I'm interested personally in who the Presidential winner is going to be. But from the standpoint of the primary trend of the market, it's not going to make that much difference. A bull market began in December, 1974, and come hell or high water that bull market is going to express itself before it fades into history. Today's ***Christian Science Monitor*** comments that only one thing is sure at this time, and that is that "***The Presidency is up for grabs--and so is the stock market.***" They may be right about the Presidency, but they're dead wrong about the market. Primary trends don't end on news events, Presidential elections, earthquakes, record earnings or new tax laws. Primary trends end with ***exhaustion*** of the bull (or bear) forces which produced them. And that's the only way they end.

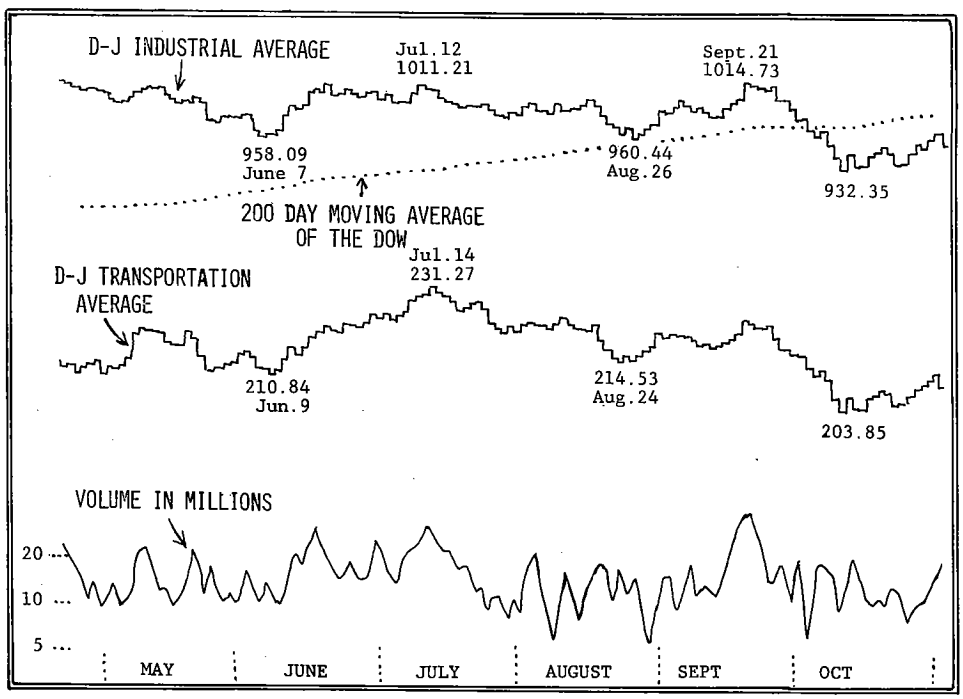
Primary bull markets are born amid black pessimism, shocking news, depressing newspaper headlines and accompanying high stock yields, low price/earnings ratios and "great values" in equities. They also start around the time the leading experts announce that "the market will cut itself in half again within six months." All those conditions prevailed at the 1974 lows.

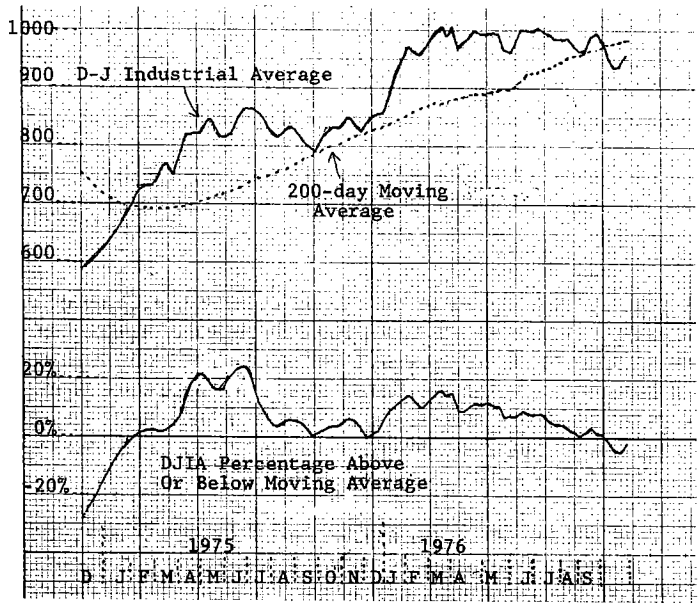
I've said it before, but I'll say it again. After the black of night comes the dawn, and after the dawn comes the daylight. Next comes the sunlight and the dancing (preparatory to the dusk, evening and final darkness again). Well, we saw the dawn in 1974 and we're seeing some daylight now. Before this bull market is over the sun is going to come out, and I'll stake whatever reputation I have in this business that ultimately we're going to see some dancing too. I don't know whether the dancing is going to be the Fox Trot or the Lindy Hop or the Bump, but there's going to be dancing for those who stick around and hang tough.

Over the past few weeks people from all corners of the globe have been calling to ask if the Averages gave "a bear signal" when they broke below the August lows a few weeks ago. I tell them, "No, you don't get primary bear signals in the second conservative phase of a bull market (where we are now); you only get valid primary bear signals during the third phase of a bull market." The third phase of a bull market is the speculative phase, the hot-rumor phase, the phase where the stocks, the brokers and Wall Street are all "flying" like a bunch of Beverly Hills advertising executives on their ninth cup of coffee.

No, we're just not there yet, and the fact is that we have to deal with this much more difficult second phase of the bull market, which probably has a long way to go. I said in the last Letter that I thought the October 12 lows of 932.35 (Industrials) and 203.85 (Transports) were probably THE correction lows. I'll stick with that opinion. The Averages have now formed decisive upward zig-zags, and volume is starting to pick up on the upside. On November 1 premier leadership was provided the market by General Motors, which punched to a new bull market high accompanied by impressive volume. Daily new highs are moving well ahead of daily new lows (on a comparison basis), and the whole stock market structure has been fortified by a fine performance on the part of bonds and the D-J Utility Average (the latter never moved appreciably below its September 21 high of 99.02).

The 200-day moving average (MA) of the Dow Industrials now stands at about 984. During bull markets, penetrations by the Dow under the 200-day MA are considered "buy spots" and I think that is what we are looking at now. The 200-day MA will often offer some resistance on the upside, and we should not be too surprised if the market gets ragged or even reacts again as and when the Dow pushes into the area of the MA. But if the Dow rallies to 984, consolidates, tends to hold its gain, and then






pushes above the MA area, then my feeling is that we will be in for some powerful upside action.

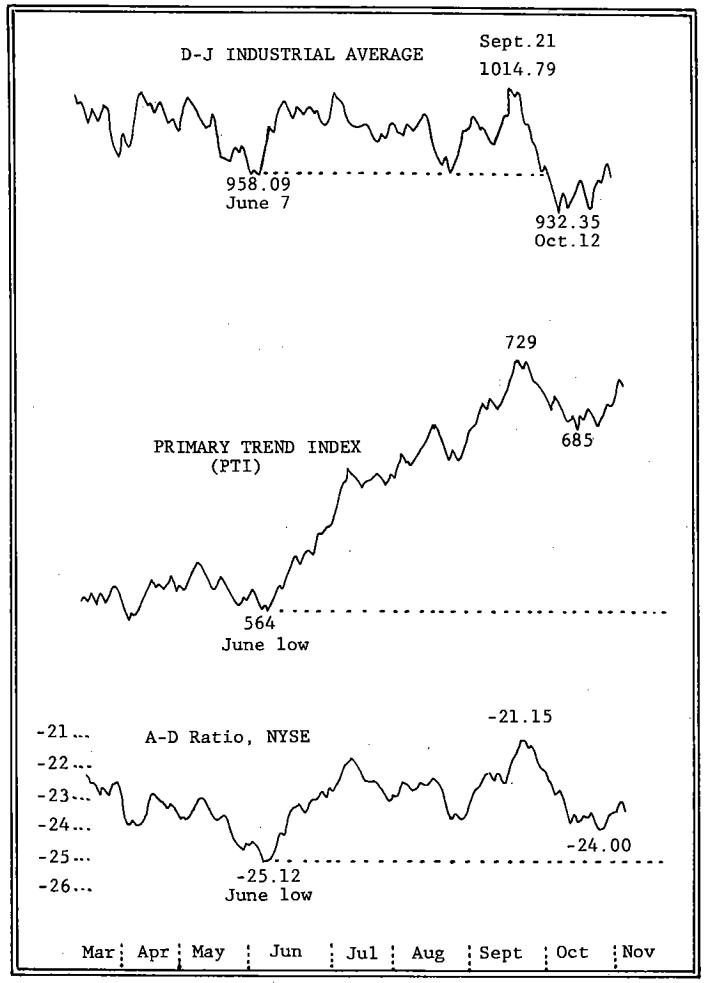
Those who insist on labelling this "a big advance in a continuing bear market" (and many still do) are, I believe, going to be frustrated and even flabbergasted once this bull market gets his temper up, and starts snorting and tossing those horns. Remember, despite all uncertainty and erratic action, this primary bull market is still in force. It has been ***held back*** for eight months now---ever since the February, 1976 peak.

Meanwhile, the odd lot public has been selling its head off, the mutual fund public has been turning in its shares, the professionals have been exceedingly careful, the money managers have been swapping stock certificates for bonds. The disbelief in the bull market has been widespread, persistent and unceasing. Ultimately, however, the primary trend is going to have its way, and I don't care whether it happens in November, 1976 or November, 1977. As a rule, the ***longer*** the primary trend is repressed, the ***more powerful the ultimate expression*** of the primary trend.

NON-CONFIRMATION: In the last Letter I presented my reasons for thinking that the October 12 lows for the Averages (and the market) were probably THE LOWS for the 1976 reaction. I showed a series of breadth measurements on the page 2 chart with the comment that although the Dow Industrials had penetrated its June low of 958.09, not one of these indices had confirmed on the downside.

On page 6 of the last Letter I also included a chart of the four major Composite Averages which I follow. Here again, we had a case of non-confirmation. For although the Value Line and Dow-65 Composites did break their June lows, the Standard & Poor's 500 and the NYSE Composites held above the June lows. Thus, we were seeing real resistance to decline during the widely-advertised September-October "swoon."

A further examination of the situation is warranted in this report. I include (this page) a daily profile of the Dow Industrials. Below the Dow is my Primary Trend Index (PTI) which is a breadth index of eight critical technical indicators. So broad is the technical spectrum covered by the PTI that (1) it is literally impossible for the PTI to collapse without the market's going down




with it, and (2) by the same token it is literally impossible for the PTI to hold while the Averages fall away.

I have had five years of experience with the PTI, and I have seen it work in the bear market and in the bull market. In the bear market, the PTI would usually stall or rise sluggishly while the Dow was bouncing (correcting) upward. Then as if waiting for the signal, the PTI would dive at the first sign of internal weakness (while the Dow invariably followed it down).

Since late-1974 when the primary bull market began, the PTI has been a huge help to me, and I have been most at sea when I refused to believe what the PTI was saying. With that wordy preamble, let's examine the Dow-PTI action now.

From the June, 1976 low of 564 to the September 21 bull market high of 729, the PTI gained a whopping 165 points while the Dow tacked on a mere 56 points. On the decline from its September 21 peak (1014.79) to its October 12 low (932.35),the Dow lost 82 points or all of its June to October gains and then some. But note that on the same September to October sell-off, the PTI lost only 44 points or a mere 26% of its June to October gains.

What this is telling us is that there has been extraordinary resistance on the part of the MAJORITY of technical indices and Averages to the late 1976 decline. Now in a primary bull market, when the market won't go down, then it's usually a pretty good bet that things are building up for a big swing on the upside. The longer the downside resistance, the greater the pessimism,

art classes, etc. I stopped in my tracks. I could literally feel the "good vibrations" emanating from this book store and from this town (which probably doesn't even appear on most maps of California).

I don't know exactly why, but at that moment something in my unconscious seemed to click. I remembered that only three years ago it appeared "obvious" that the US was heading for disaster. It seemed equally clear that the center of world power was moving from the US to Europe. Europe (under the leadership of France and West Germany) was assuming command, while Nixon and gold seemed to be digging a grave for the US.

Then I thought, "How the times have changed." Russia is currently having severe economic problems, her credit is endangered, and she may even have to cut her mighty defense budget. Africa is in turmoil, the Mid-East is in flux, and Arab money has been moving to the US. Italy is on the verge of total collapse, France is staggering under inflation, Britain has become at best a second-rate power. But China is turning increasingly to the US for friendship, and it could be that 800 million Chinese know what they are doing.

In fact, of thirteen medium-sized and major stock markets including Britain, Canada, Denmark, Japan, West Germany, Australia, Belgium, Holland, Sweden, Switzerland, Italy, Spain, and France, only one has outperformed the US stock market since January, 1975. That one is Australia, and the relative strength of the Australian market (compared with the US) has been dropping rapidly over the past two months. Those relative strength figures should tell us something.

I believe that the next ten years are going to see the US re-emerge as the spiritual, economic and political leader of the world. I believe that Vietnam, Watergate, the drug scene, the crime explosion, all those many tragic experiences, represented a kind of purging for the US prior to its new emerging period of world leadership. Perhaps the clean sweep of the 1976 Nobel Prizes by the US represented an early vision of things to come. Perhaps the January, 1975 primary bull signal was the trigger that ushered in the "new age" for America. One way or another, I think it is coming.

The "good vibrations" I felt in Encinitas set off this brainstorm of mine. True, the thoughts had been brewing in my head for many months, but it was the feel of this West Coast town that caused all those ideas to jell. Obviously, I could be wrong, and it is possible that nothing may turn out the way I see it. But I believe I am correct, and that's why I'm writing about it now.

QUESTION: That's all great, if it happens, Russell, but what about all those huge problems that won't go away? For instance, what about the sky-rocketing US debts?

ANSWER: The pendulum has a habit of swinging both ways, even though most of us either don't notice the swings (or perhaps we don't know the meaning of the swings). For instance, it is becoming clear that the American people are getting fed up with debt and the manufacture of debt. In a word, Americans are turning rather conservative, and we see it in the sluggish (but not bearish) economic statistics. In an article in the October 29 ***Wall Street Journal*** entitled ***"The New Mood in Public Spending,"*** Paul McCracken points to this mood and he also points to new legislation which is calculated to limit spending by law.

A few weeks ago Nobel Prize winning economist Milton Friedman cited the US need for a Constitutional amendment setting a limit to Government spending! As if this thought is not extraordinary enough, think how amazing it is that Socialist Sweden (although the Socialists have now been voted out) elected capitalist-thinking Friedman to the ranks of Nobel Prize winner.

As the final shocker which I feel reflects not only growing US conservatism but perhaps even world conservatism, it can now be said that (despite all sorts of official predictions) the world's population growth rate is slowing down. It has been widely known that the US birth rate is sliding, but now we hear that the new trend is spreading throughout the world. Thus, one of the worst fears of the Club of Rome, the demographers and the economists is evaporating. It just could be that this bull market is going to have, as one of its cornerstones, a severe case of "universal sanity." Can you imagine what the market would do if world peace, conservatism and sanity ever "took over"?

CARTER: The news is in. Jimmy Carter is to be our next President. So be it. There are some who take pride in calling this nation "a republic," rather than a democracy. But a republic is merely a nation which is not run by a monarch. ***America is a democracy,*** run by the will and the votes of the people. It is a fundamental tenet of democracy that the people's welfare and good are ***safer*** when placed in their own hands than in the hands of any single man or group of men.

Ironically, in this morning's newspaper I read where Indira Ghandi has forced through an amendment to India's 26-year old constitution which rewrites the preamble and changes 59 clauses. She has virtually placed herself in the position of dictator. In the same paper I read where a military coup has toppled yet another African nation, this time Burundi. And finally (still in the same paper) I note that Ethiopia has executed 23 "anarchists and reactionaries" for the good of the new state. So remember, we still change our leaders in the US via the voting machine, not the bullet and the bayonet.

I was not a Carter fan, but if the mass of people want him, there may well be more in him than I could see. Certainly, Ford was no inspiration. He carried the taint of the Nixon pardon with him, he appeared inarticulate in the debates with Carter, but he was a known quantity. When the people trade a known quantity for a relatively unknown quantity, they are saying that they want change.

Under democracy the people take responsibility for their mistakes and their victories. My bet is that Carter will not be as "bad" as many of us fiscal conservatives think he'll be, and he may turn out to be a lot better than the pessimists think. What a man says when he's trying to win an election, and what he does after the election often vary considerably. And we might remember, speaking of conservative policies that Ford promised a tax cut if elected--while Carter did not. Carter said he'd have to look over the situation and decide whether a tax cut was warranted. So, we'll hold our judgments in abeyance, but the will of the people has prevailed, and I'm all for that.

TOPS: It is interesting to compare the market situation now with that of the primary bull market top of February, 1966. It is particularly interesting to compare the two periods because the Dow today is within 30-40 points of where it was when it topped out in February, 1966 at 995.15.

Corporate profits in 1966 were running around $48 billion against about $83 billion today. In other words, they're about 75% higher now. Dividends were running around $19.6 billion

then, while they are running $34.4 billion today, an increase of 76%. The P/E ratio for the Dow at the 1966 top was about 17 while today it is much more conservative, running around 10. What I am saying is that the market as a whole, and the Dow too, are relative ***values today*** compared to the market and the Dow at the 1966 top.

LATE NOTES: The market opened with a downside thump today, under fear selling brought on by the "shocking news" of a Carter victory. I ask myself who would dump stocks on that kind of news? Certainly, a Carter victory was an obvious possibility, and when you consider the great percentage of the voting population in this country which is Democratic, it is hard to believe that a Carter victory could have come as a surprise to any thinking man. Therefore, I have to consider the quality of the selling which occurred on the news as poor.

Secondly, the old market adage states that "the market's first reaction to news is usually the wrong one—or opposite the prevailing trend." We'll have a chance to test that adage in the next week or so.

But what interests me is the highly emotional quality of this market, the tendency of the market to panic on any kind of adverse news or turn of events. I feel that this "opening panic" based on the Carter election fits right in with the "urgent selling" thesis which I discussed on page 4. During the first hour of the selling (November 3) there were 99 issues on the NYSE advancing and over 1100 declining, a ratio of 11 to 1. That's ***panic*** action, ***emotional*** action, action which suggests that there is still a tremendous amount of ***fear*** around. The character of the November 3 market is hardly suggestive of the euphoric atmosphere that prevails for weeks (and even months) at a major bull market top.

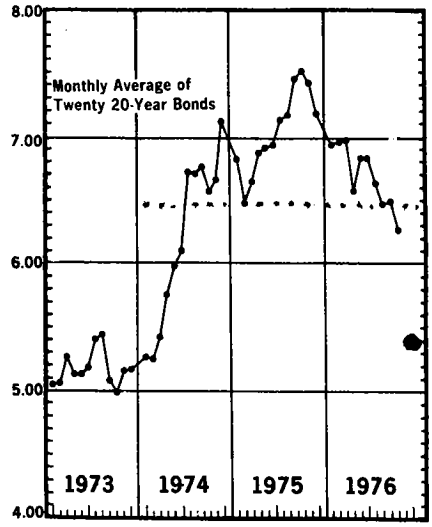
Again I say, watch the October 12 low of 932.35 (Industrials) and 203.85 (Transports). Those were the lows which were recorded when a Carter victory seem assured, and therefore I feel that the market at the October 12 lows was discounting its worst worries about a Carter victory.

The market seldom discounts the same thing twice, but when it is scared enough or emotional enough, the Averages will test and re-test preceding lows. It may be that there are sufficient doubts about Carter so that the Averages will come down to test the 932.35 and 203.85 lows again, although I rather doubt it at this time.

If the Averages do retreat here, it will be important to see how they act at the October 12 lows. As long as ***one or both Averages*** hold above the 932.35 (Industrials) and 203.85 (Transports) lows, the situation will remain constructive, and I will hold to my opinion that base-building is going on. However, if both October lows are violated (particularly on increasing volume), then I would have to take such action seriously. In that event, I would say that subscribers should assume a very defensive position, cutting back substantially on common stock holdings.

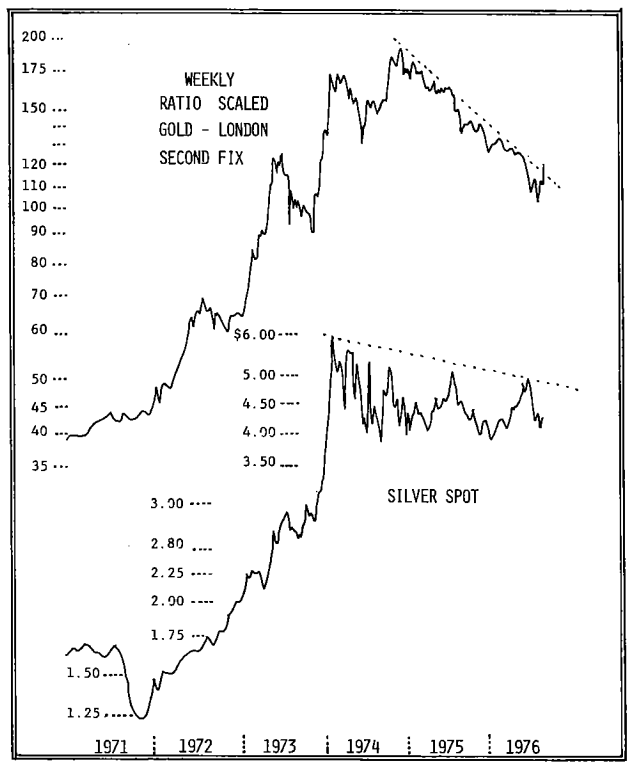
I'll repeat, I think this market is emotional, I think it would panic if Barbara Walters appeared on TV in a Donald Duck mask, but I don't want to be a wise guy. As I've said before, there must be a place at which every investor pays the cost of insurance against possible major losses of capital, and I consider the October 12 lows the "insurance line."

BONDS: This chart of the yields on 20 selected bonds (20 year maturities) would seem to tell the story about the bond market.




As I've said again and again the bonds are in a primary bull trend. As you can see on the chart, a huge "head and shoulders top" has formed in the yields, and since bond yields are an ***inverse*** function of bond prices, it is obvious that a head-and-shoulders bottom has formed in bond prices. However, the drop in yields has been very rapid, and a ***correction*** to higher yields is now in order.

The chart shows that the most recent drop in bond yields has taken the yields below their 1975-76 lows. A simple "count" based on the H&S projection, suggests that these bond yields should (in time) drop down to at least the 5.5% area (black dot on the chart). But since projections in bull markets often run past their minimum technical count, it could be that bond yields will decline farther than even the optimists think. Is the market telling us that Carter is going to be a conservative? Will Burns stay on as head of the Fed? Is the nation or the Government (or both) moving into a new era of rising liquidity? The chart is bullish, and we'll have to leave the reasons and answers to tomorrow's headlines. (Bond chart from the ***Wall Street Journal***).




GOLD, SILVER: Last week gold reversed the long, bearish trendlin which has been traced out by the bear market decline from the 1974 peak. I said before that I thought the 103 low of August 26 would be THE low, and I'm almost sure of that now. But the question is, will gold really move out on the upside now? I rather doubt it. I still see nothing wrong with 5% or so in modern gold coins (purchased for gold content), but I don't think the big killing in gold is just ahead—not yet. *Homestake* has reversed a one-year decline in relative strength, and it is the only gold stock that can be held without fear of confiscation or racial upheaval. At the current price of about 125 for gold, *Homestakes's* gold operation is probably just moving into the black.

NEXT MAILING: November 17th.